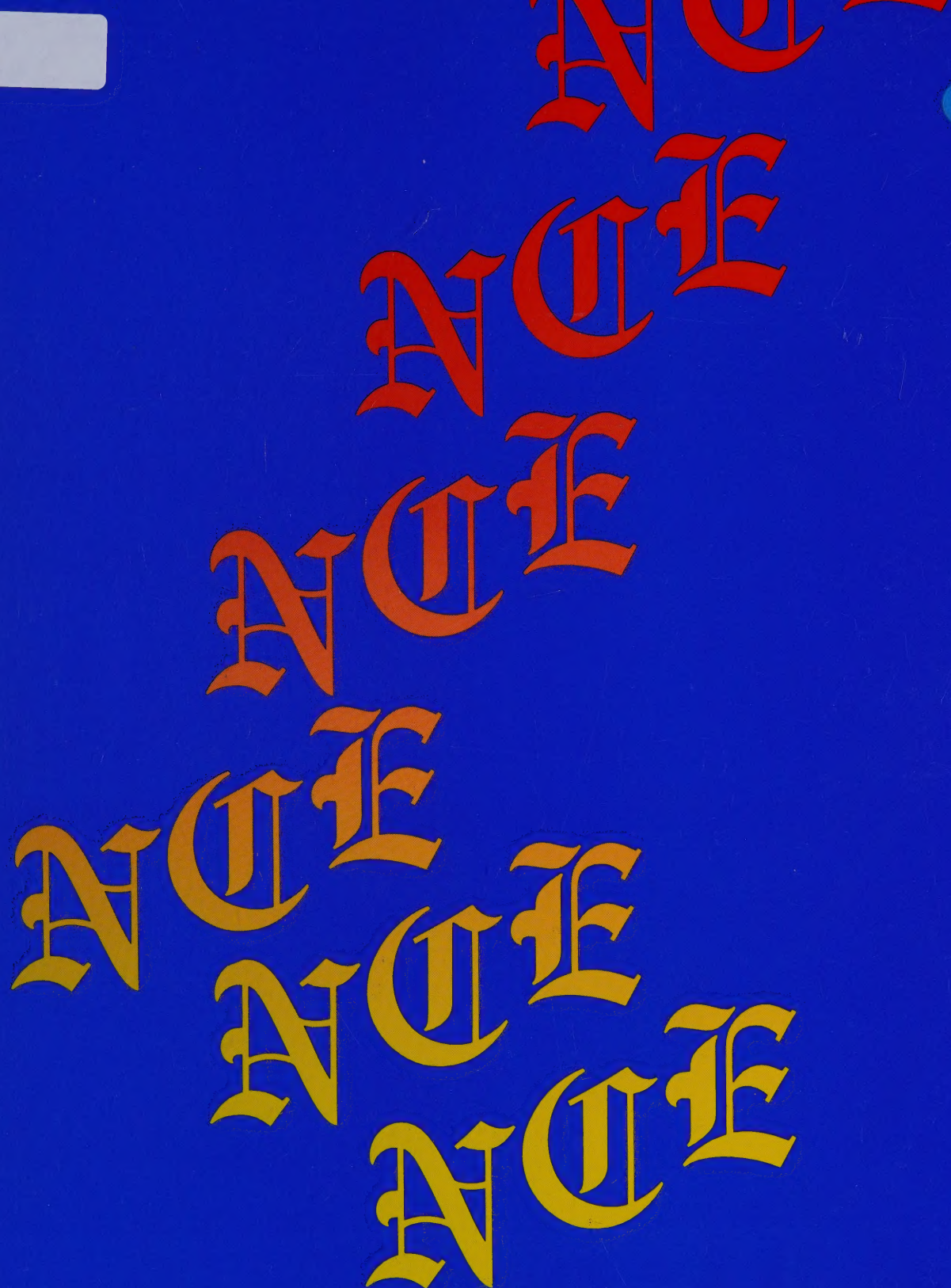




North Continental Energy Ltd.

1986 ANNUAL REPORT

North Continental Energy Ltd.

CORPORATE INFORMATION

REGISTERED OFFICE:

104, 1410 Mayor Magrath Drive
Lethbridge, Alberta
Canada T1K 2R3
Phone (403) 328-4010

LEGAL COUNSEL:

Huckvale & Co.
612 - 3rd Avenue South
Lethbridge, Alberta
Canada T1J 4A2

AUDITORS:

Munton/Copeland/Anderson
200, 1410 Mayor Magrath Drive
Lethbridge, Alberta
Canada T1K 2R3

TRANSFER AGENT:

Central Trust Company
401 - 8th Avenue S.W.
Calgary, Alberta
Canada T2P 1E4

STOCK EXCHANGE:

Alberta Stock Exchange
Trading Symbol – NCL

BANKER:

Bank of Montreal
Lethbridge, Alberta

North Continental Energy Ltd.

PRESIDENT'S REPORT

To the SHAREHOLDERS:

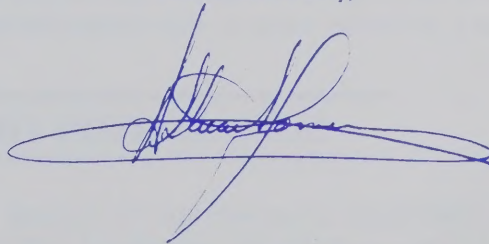
The changes which were voted on at the last Annual Meeting have been successfully completed. The conversion of shares from North Continental Oil & Gas Corporation Limited to North Continental Energy Ltd. is 75% completed.

The Company has acquired a 33.33% working interest in 8,640 gross acres or 2,768 net acres of Crown Lease lands. We have also acquired a 16.67% interest in 640 acres at Black Butte, Alberta. Of the lands acquired, ten sections are in one block just east of Warner, Alberta and two sections are in the Verdigris Coulee east of Milk River, Alberta.

In 1986 three wells were drilled on these properties. Two wells showed encouraging results and our geologists are doing an analysis to determine the next drill sites. The company will be doing further testing on these lands in 1987.

At Hanna, Alberta we have a 16.884% interest in two gas wells and a gas plant. A new vapour recovery unit has been added to the plant. We have, as of November 1986, tied the second well into the plant and put it into production. Gulf Canada Resources is the operator of the project. Our share of the marketable gas reserves in the field is 319 million cubic feet. The gas is being sold under a long-term contract to Trans-Canada Pipelines Ltd.

Yours Sincerely,

A handwritten signature in blue ink, appearing to read 'A. Stuart Cameron', is written over a horizontal line.

A. Stuart Cameron
President

North Continental Energy Ltd.

NOTICE OF ANNUAL MEETING

NOTICE OF ANNUAL GENERAL MEETING OF SHAREHOLDERS TO BE HELD THE 29th DAY OF MAY, 1987

TAKE NOTICE that on the aforesaid date, at the Magrath Room, Sven Ericksen's Family Restaurant, 1715 Mayor Magrath Drive, in the City of Lethbridge, in the Province of Alberta, at 2 o'clock in the afternoon, there will be convened a general meeting of all Shareholders of North Continental Energy Ltd. The meeting will consider the following:

1. The appointment of Munton/Copeland/Anderson as Company auditors.
2. The meeting is also for the purpose of receiving and considering the reports of the Directors, the Auditor's report, the Financial Statements, the election of Directors and the transaction of any other business as may properly come before the meeting.

VOTING RIGHTS

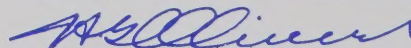
3. Proxies in the form enclosed; which are properly executed, returned to management and not revoked; will be voted at such meeting in accordance with the authority contained therein. Any such proxy may be revoked before it is exercised.
4. 2,295,804 Common Shares without par value of the Company are outstanding each of which entitles the holder to one vote at all meetings of the Shareholders.
5. A shareholder has the right to appoint a person (who need not be a Shareholder) to attend and act for him on his behalf at the meeting other than the persons designated in the enclosed form of proxy. To exercise the right, the Shareholder may insert the name of the desired person in the blank space provided in the proxy or may submit another appropriate proxy. The proxy also confers discretionary authority with respect to amendments or variations to matters identified in the Notice of Meeting and other matters which may properly come before the meeting.
6. Those Shareholders desiring to be represented thereat by a nominee must deposit their proxies with the Corporate Secretary 48 hours prior to the commencement of the meeting.

SOLICITATION OF PROXIES

7. The costs of this solicitation of proxies for the Annual General Meeting of Shareholders are being borne by the Company. It is planned that the solicitation will initially be by mail but proxies may also be solicited by regular employees of the Company.

If you are unable to be present would you kindly sign, have witnessed and return the enclosed proxy. Dated at the City of Lethbridge, Alberta this 10th day of April, 1987.

BY ORDER OF THE BOARD OF DIRECTORS



H. Gordon Oliver, Secretary Treasurer

North Continental Energy Ltd.

AUDITOR'S REPORT

To the Shareholders of
North Continental Energy Ltd.

We have examined the balance sheet of North Continental Energy Ltd. as at December 31, 1986 and the statements of income and retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the company as at December 31, 1986 and the results of its operations and changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Munton / Copeland / Anderson

Munton/Copeland/Anderson
Chartered Accountants

Lethbridge, Alberta
March 18, 1987

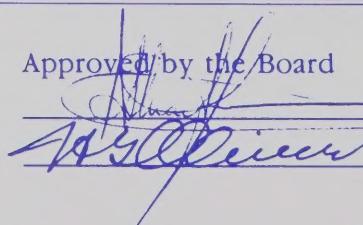
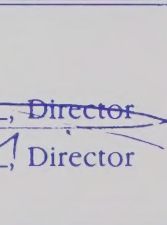
North Continental Energy Ltd.

BALANCE SHEET

December 31, 1986

	1986	1985
ASSETS		
CURRENT		
Cash	\$ —	\$ 91,410
Accounts receivable	103,592	57,240
Alberta Royalty Tax Credit	23,586	40,699
Income taxes recoverable	23,719	—
	<u>150,897</u>	<u>189,349</u>
DUE FROM AFFILIATED COMPANY		
Keho Holdings Ltd.	—	74,169
INVESTMENTS (Note 2)	788,462	771,872
PROPERTY AND EQUIPMENT (Note 3)	381,325	200,667
	<u>\$1,320,684</u>	<u>\$1,236,057</u>
LIABILITIES		
CURRENT		
Bank indebtedness (Note 4)	\$ 42,161	\$ —
Accounts payable	21,623	29,915
Income taxes payable	—	24,465
	<u>63,784</u>	<u>54,380</u>
DEFERRED REVENUE (Note 5)	101,101	63,989
DUE TO BARONS OIL LTD., an affiliated company	—	161,389
DEFERRED INCOME TAXES	42,661	—
SHAREHOLDERS' EQUITY		
SHARE CAPITAL		
Authorized		
20,000,000 common shares, no par value		
Issued		
2,295,804 common shares (Note 6)	929,486	779,500
CONTRIBUTED SURPLUS	32,923	32,923
RETAINED EARNINGS	150,729	143,876
	<u>1,113,138</u>	<u>956,299</u>
	<u>\$1,320,684</u>	<u>\$1,236,057</u>

Approved by the Board

 Director
 Director

North Continental Energy Ltd.

STATEMENT OF INCOME

Year Ended December 31, 1986

	1986	1985
REVENUE		
Dividends and interest	\$ 5,496	\$ 118,651
Natural gas and oil sales	106,801	201,542
Less: Royalties	(35,962)	(85,458)
Add: Alberta Royalty Tax Credits	23,586	40,699
Drilling grants	8,329	—
	<u>108,250</u>	<u>275,434</u>
EXPENSES		
Officers salary	30,000	—
Operating	16,375	30,089
General and administrative	18,399	13,650
Depreciation	17,681	7,509
	<u>82,455</u>	<u>51,248</u>
Income before income taxes	25,795	224,186
Income taxes – recovered	(23,719)	24,465
– deferred	42,661	—
NET INCOME	\$ 6,853	\$ 199,721

STATEMENT OF RETAINED EARNINGS

Year Ended December 31, 1986

	1986	1985
RETAINED EARNINGS (DEFICIT) BEGINNING OF YEAR	\$ 143,876	\$ (55,845)
Net income	6,853	199,721
RETAINED EARNINGS END OF YEAR	\$ 150,729	\$ 143,876

North Continental Energy Ltd.

STATEMENT OF CHANGES IN FINANCIAL POSITION

Year Ended December 31, 1986

	1986	1985
SOURCE OF FUNDS		
Operations		
Net income	\$ 6,853	\$ 199,721
Add items not requiring funds		
Deferred income taxes	42,661	—
Depreciation	17,681	7,509
	<u>67,195</u>	<u>207,230</u>
Repayment of loan from affiliated company	74,169	—
Issuance of shares	150,000	—
Deferred revenue loan	52,434	—
Prior period adjustment	—	19,395
	<u>343,798</u>	<u>226,625</u>
USE OF FUNDS		
Purchase of property and equipment	198,339	—
Repayment deferred revenue loan	15,323	8,726
Repayment to affiliated company	161,389	—
Purchase of shares	13	—
Purchase of investments	16,590	132,593
	<u>391,654</u>	<u>141,319</u>
INCREASE (DECREASE) IN WORKING CAPITAL	(47,856)	85,306
WORKING CAPITAL, BEGINNING OF YEAR	134,969	49,663
WORKING CAPITAL, END OF YEAR	\$ 87,113	\$ 134,969
WORKING CAPITAL REPRESENTED BY:		
Current assets	\$ 150,897	\$ 189,349
Current liabilities	63,784	54,380
	<u>\$ 87,113</u>	<u>\$ 134,969</u>

North Continental Energy Ltd.

NOTES TO FINANCIAL STATEMENTS

December 31, 1986

1. ACCOUNTING POLICIES

North Continental Energy Ltd. is a public company which produces natural gas and oil and is incorporated under the Alberta Business Corporations Act. These financial statements are prepared in accordance with generally accepted accounting principles. The more significant accounting policies are:

Fixed Assets

Fixed assets are recorded at cost. Depreciation is calculated using the straight line method at the following rates:

Dehydration plant	5%
Non-producing properties	10%

Investments

Investments are recorded at cost.

Income Taxes

The Company records income taxes on the tax allocation basis. Under this method, income taxes relating to earnings currently recognized for accounting purposes but deferred for income tax purposes are fully provided.

2. INVESTMENTS

	1986	1985
Barons Oil Limited: 289,800 shares at costs (market value 1986 - \$840,420; 1985 - \$1,410,750)	\$741,962	\$725,372
325521 Alberta Ltd.; 180 shares at cost	46,500	46,500
	\$788,462	\$771,872

3. PROPERTY AND EQUIPMENT

	1986		1985	
	Cost	Accumulated Depreciation	Net	Net
Office Furniture	\$ 110	\$ 110	\$ —	\$ —
Dehydration plant	164,010	71,444	92,566	86,938
Investment in Natural gas well (16.884%)	11,854	—	11,854	11,854
Investment in Oil and gas well (6.25%)	101,875	—	101,875	101,875
Land	88,665	—	88,665	—
Investment tax credits	1,041	—	1,041	—
Non-producing properties	94,804	9,480	85,324	—
	\$ 462,359	\$ 81,034	\$ 381,325	\$ 200,667

North Continental Energy Ltd.

NOTES TO FINANCIAL STATEMENTS

December 31, 1986

4. BANK INDEBTEDNESS

Bank indebtedness consists of:

Cheques issued in excess of funds on deposit	\$ 12,161
Demand loan	30,000
	\$ 42,161

5. DEFERRED REVENUE

Deferred gas revenue consists of amounts received under take-or-pay gas contracts and will be recognized as revenue when the related product is delivered to the purchaser.

6. SHARE CAPITAL

During the year four shares of North Continental Oil and Gas Corporation Limited were exchanged for one share of North Continental Energy Ltd. In addition 120,000 shares were issued to Barons Oil Ltd. for partial payment of their debt. The executive officers of the company were issued 30,000 shares in lieu of salary.

Shares issued to shareholders	\$1,878,304
Treasury shares	417,500
Total issued shares	\$2,295,804

North Continental Energy Ltd.

OFFICERS OF THE COMPANY

A. STUART CAMERON

President

HOWARD H. OLIVER

Vice President

H. GORDON OLIVER

Secretary Treasurer

DIRECTORS OF THE COMPANY

HOWARD H. OLIVER

A. STUART CAMERON

H. GORDON OLIVER

NORMAN E. WADE

DONALD R. OLIVER

ANNUAL MEETING

2:00 p.m., May 29, 1987
Magrath Room, Sven Ericksen's Family Restaurant
1715 Mayor Magrath Drive
Lethbridge, Alberta

North Continental Energy Ltd.

1986 ANNUAL REPORT